

Aviation Alliances

Written Testimony of

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Before The

Senate Committee on Commerce, Science, and Transportation

June 4, 1998

Good Afternoon, Mr. Chairman, I am Hershel Kamen, Staff Vice President of International and Regulatory Affairs for Continental Airlines. It is a pleasure to be here representing my 40,000 colleagues at Continental and I thank you for inviting a representative of the proposed Continental/Northwest alliance to this hearing. Your intention to take testimony today on the impact of the proposed aviation alliances and their effects on consumers and on competition within the airline industry is well timed.

Today, I intend to distinguish for the Committee the different types of alliances which exist, to discuss the nature and specifics of the Continental/Northwest alliance, to clearly delineate the consumer benefits of the Continental/Northwest alliance, to identify the differences between the Continental/Northwest alliance and the other two proposed domestic alliances, and to describe the extensive review which the government has undertaken of our alliance.

Let me start my testimony by briefly highlighting some of the fundamental bases that distinguish different alliances. Mr. Chairman,

not all alliances are alike. Whether an alliance is a domestic or an international alliance, they fall into one of two categories – they are either a pro-competitive end-to-end alliance or an anti-competitive horizontal overlapping alliance. Alliances that are primarily end-to-end provide the airlines involved with access to city-pairs and routes to which they would not otherwise have access. End-to-end alliances, like our successful pro-competitive alliances with Alitalia or America West, to name just two examples, allow more people to go more places with more options, a tremendous consumer benefit. End-to-end alliances extend the network reach of each airline partner and provide consumers with more travel options and enhanced service. These alliances also make it possible for cities to receive service that would not be economically viable in the absence of the alliance. The Department of Justice has noted in comments filed with the Department of Transportation that, “Potential public interest benefits occur when an airline extends the reach of its route network by code-sharing on flights operated by an airline that operates a route network in another geographic region—i.e., an end-to-end network combination.” We agree.

On the other hand, horizontal overlapping alliances are anti-competitive, anti-consumer and should not be encouraged or approved by our government. Characteristics of this type of alliance include:

- Reduction of competition without substantial consumer benefits
- Large combined market shares
- Regional domination
- Control of the largest or most important gateways
- Closure of key gateways to expansion or competition
 - Foreclosure of other procompetitive end-to-end alliances

While some largely horizontal alliances produce limited end-to-end benefits, the adverse effect of reducing competition far outweighs the insignificant end-to-end benefit. The Justice Department has stated that where competitive benefits are high and the number of overlaps are low, the risk to loss of competition is outweighed by the potential benefits. However, according to the Department of Justice, “The obverse is also true.” As the Department has indicated, “the potential for code-share agreements between largely horizontal networks to

create pro-competitive benefits and promote the public interest, is relatively low; and the risk to competition is relatively high.” Once again, we agree.

It is important to distinguish among alliances on these bases in order to accept the fact that all alliances are not created equal. Continental firmly believes that alliances should be approved only if the consumer benefits outweigh any competitive reductions. We also firmly believe that the Continental/Northwest alliance is a good example of a pro-competitive, end-to-end alliance. Let me elaborate.

The Continental/Northwest strategic alliance is an end-to-end alliance that will offer consumers increased service options, better connections, and a new domestic and global network competitor.

Through the alliance, Continental and Northwest plan to engage in a variety of joint marketing and operational activities to provide increased utility to our customers and to enhance the competitiveness of both airlines. The two airlines plan to provide coordination of connecting flight schedules, codesharing (both domestically and

internationally), reciprocal frequent flyer programs, reciprocal lounge access, and airport facility coordination. The airlines will coordinate to provide for a common physical product and will work towards a common service standard. Additionally we intend to provide seamless service, including one-stop check-in for seat assignment and boarding passes, baggage transfer, and operations systems compatibility. It is important to note that Continental and Northwest will not jointly price or engage in joint scheduling in the U.S. Each airline will price and schedule individually. This independent pricing and scheduling scenario is the same as currently used by Continental in its highly successful alliance with America West.

The Continental/Northwest alliance will create a fourth new network to compete with the existing “Big Three” airlines in the U.S. A review of our two systems will show you that Continental and Northwest do not operate hubs at common airports and our geographic scope is enhanced by hubs in different regions. Over 150 cities, 2000 city-pairs, and three million passengers will gain a new airline competitor and new online connections through the alliance (passenger surveys

continue to show that while passengers can often get between two cities by using “interline” connections, they vastly prefer the seamless service of an on-line connection). Our proposed alliance will create significant new competition from the U.S. to Central and South America, a region not served by Northwest today. In recent years, Continental has dramatically increased the number of destinations in South and Central America in an effort to compete with American's dominance on routes in this region -- support from the Northwest network will clearly help Continental become a more viable competitor in Latin America. Additionally, our proposed alliance will yield significant new competition from the U.S. to Asia. Continental currently operates no flights between the U.S. mainland and Asia and we are looking forward to starting our first non-stop flights from the mainland (Newark and Houston to Tokyo) later this year. Because of our alliance with Northwest, we will be able to offer our passengers service to much of Asia that we could not do on our own, significantly increasing competition. While Northwest has a strong system in Asia, support from the Continental network will enable Northwest to compete with the announced American/Japan Airlines and

United/ANA mega-Asian alliances.

But what about the issue of system overlap? Public rhetoric about the three proposed domestic alliances tends to focus on “consolidation” and “overlap”. This is not a factor in the Continental/Northwest alliance. The combined systems of Continental and Northwest include only seven overlapping non-stop domestic routes. These seven routes (hub to hub cities) constitute only .03% of the combined systems. There are an additional 168 one-stop and two-stop routes where there is some overlap between Continental and Northwest, but these routes constitute less than one percent of the approximately 18,500 city-pairs served by the two airlines. On most of these routes, there is another airline that is at least the size of Continental or Northwest or that holds at least 10% of the market share. These data prove that we are proposing a pro-competitive end-to-end alliance because there is virtually no competitive overlap between the networks.

Another key attribute of the Continental/Northwest alliance is that even

if they were combined, the two airlines would account for only 16.6% of the domestic U.S. revenue passenger miles, a percentage that still would rank the combined network as only the fourth largest U.S. network, behind Delta (17.5%), United (16.9%) and American (16.8%) today. The alliance between Continental and Northwest will not drive competition out of the market; rather it will create an enhanced network to compete with the “Big Three”. Continental’s current domestic market share ranks Continental as only the sixth largest U.S. carrier, less than half the size of Delta, United, or American, and approximately 15- 20% smaller than Northwest or US Airways. While we have dramatically improved the quality of our product over the last three years (and winning all kinds of awards in the process), our current size will ultimately limit our ability to compete both here and abroad. The Continental/Northwest alliance is critical if we are to be able to compete with significantly larger domestic competitors and the creation of global alliance networks like United’s Star Alliance, and, if it wins approval, the proposed American/Japan Airlines/British Airways Alliance.

Consumer benefits will be achieved with the Continental/Northwest alliance. The creation of new online options for the U.S. consumer is just one key benefit of the alliance. As the vast majority of routes served by Continental and Northwest do not overlap, a great number of city-pairs will gain a new competitor, new service options, and access to a new route network. Consider a city like Spokane, Washington. Northwest is currently one of six airlines flying to Spokane; however, Continental does not fly to Spokane at all. Now let's consider destinations like Belize City, Belize or McAllen, Texas. There are currently no online options available between Spokane and these two cities. Continental does not serve Spokane; Northwest does not serve either Belize City or McAllen. By linking the Continental and Northwest systems, both airlines will now serve these cities and offer online connections between them. Competition and choice have been created.

However, the benefits to consumers are not limited to new online connections created by linking the Continental and Northwest systems. Consumer benefits are also created through an increase in

online frequencies on routes currently served by the two airlines, and through the creation of additional routings between cities already served. These benefits will enhance service options for millions more passengers. And these efficiencies are created without detrimental reductions in competition, large amounts of overlap, or dominant market concentration.

There are several facts which differentiate the Continental/Northwest alliance from the United/Delta and American/US Airways alliances:

- The Continental/Northwest alliance creates a network carrier that would rank only as the fourth largest U.S. domestic airline with a 16.6% domestic market share -- the proposed alliances created by United/Delta and American/US Airways would have domestic market shares of over 34% and 25%, respectively.
- The United/Delta and American/US Airways proposed alliances have a far greater number of overlap city-pairs, passengers, and revenue passenger miles than does Continental/Northwest.
- Delta, United, and American already have the largest market share

in most regions of the U.S.; their proposed alliances would make this dominance even worse.

- United/Delta and American/US Airways (with their commuter partners) would control 85% of the available slots at slot controlled airports; Continental/Northwest would use less than 8% of the slots at these same airports.

The last difference I would like to mention is that the

Continental/Northwest alliance is the only alliance that is currently under review by the Department of Justice under the Hart-Scott-Rodino Act which requires prior review of certain transactions. This review has been triggered simply because the Continental/Northwest alliance involves a purchase of Continental equity by Northwest. This review is exhaustive. Justice is evaluating our proposed alliance and its competitive effects as if we were merging with Northwest even though we are not merging. We experienced an identical review when we proposed our successful Continental/America West alliance and purchased stock in America West in 1993. The Justice Department's Hart/Scott/Rodino of Continental/Northwest review has been ongoing since February 1998 and we continue to work with officials from DOJ to supply them with the extensive materials they have requested. The antitrust laws do not require that the DOJ review the competitive

impact of the other two alliances prior to their consummation, although DOJ could certainly investigate if they chose to do so. We recognize that “government review” is an issue of interest to the Congress -- we urge that each of the transactions be judged on its own merits and certainly do not oppose a thorough review of the competitive impacts. We are confident that the Department of Justice will proceed expeditiously with their review of our pro-competitive alliance and that they will ultimately find that our proposed alliance should be approved. We would be concerned if, despite the Justice Department’s review and clearance on competitive issues which found the Continental/Northwest Alliance to be pro-competitive, we were then subject to a duplicative review at a second agency, delaying our ability to provide the consumer benefits described above.

Mr. Chairman, the consumer demand for global air service is reshaping the airline industry -- alliances clearly meet the needs and demands of the consumer. End-to-end alliances can provide substantial benefits and should be encouraged. Horizontal alliances eliminate competition and should be rejected. The

Continental/Northwest alliance is a classic end-to-end alliance with pro-consumer benefits which will enhance competition. The combined network will add a fourth competitor to the “Big Three” and will begin to provide for a third competitor in the global marketplace. Approval of this alliance will make the travelling public winners.

Mr. Chairman and members of the committee, I would like to thank you for giving me the opportunity to discuss this very important topic with you and for your attention. I would be pleased to answer any questions that you may have.